Practicing CPA, vol. 11 no. 12, December 1987

American Institute of Certified Public Accountants (AICPA)

The Practicing CPA

DECEMBER 1987

An AICPA publication for the local firm

SOME THOUGHTS ON PARTNER EVALUATION AND PERFORMANCE

Ours is a personal service profession, and the success of each firm is controlled to a considerable degree by the performances of its people. The ability to recognize and surmount shortcomings enables us to improve our performances. An evaluation by others can be helpful in this respect.

For example, candid discussions between partners are not necessarily automatic, and there may be hidden problems in a partnership that an evaluation process can bring to the surface. The adoption of a partner evaluation program represents a commitment on the part of all partners to give and accept critiques as mutually beneficial, and many firms find that it can open lines of communication which might otherwise remain closed.

No one method of evaluation is best, or even suitable, for all firms. The method should depend upon circumstances—the size of the firm, the number of partners, and the diversity or similarity of their ages, experiences, and longevity with the firm. The firm's management style and the objectives of the process should also be considerations. Whatever form the evaluation process takes, the discussions should always be honest, helpful, friendly, and empathetic. Partner communication is the key.

In reality, the evaluation process begins with the criteria you have established for admitting partners to your firm. Demonstrating technical competency, honesty, integrity, dedication, administrative ability, and support and loyalty to the firm and its philosophy and objectives is basic. In addition, a partner is expected to be innovative and to have the ability to make changes and improvements for the better, rather than merely react to others.

Partners are also expected to effectively direct and evaluate staff, diagnose the needs of clients, expand services to present clients, and attract new ones. In addition, they should bill and collect promptly with only minor adjustments from standard rates.

These expectations can be contrasted with the minimum requirements for becoming a manager. That position also includes individuals who can effectively perform existing services for present clients (including managing staff assigned to such engagements). This ability is important but in itself does not justify promotion to partner.

A firm's philosophy and objectives must be defined and periodically reassessed to assure that there is common agreement among the partners as to its mission and goals. Partners must know what is expected of them, what will be deemed exceptional performance, and what will be unacceptable in terms of the firm's value system. Then, partners must be rewarded for results, not just for activities.

Purposes of the evaluation process

An evaluation program has two purposes. The first, as just described, is to improve partners' performances. The second purpose is to allocate firm income.

Generally speaking, a CPA firm's net income results from the use of the following resources:

☐ *Tangible capital.* This is becoming more important as the profession becomes more capital intensive. We pay 10 percent annually as a return on the tangible capital balances that each partner has in our firm. →

What's Inside . . .

☐ *Intangible capital.* This is the value attributed to clients developed over the years who provide an ongoing need for services. Usually, partners who have served the firm longer have contributed more toward the accumulation of clients. Longevity, therefore, is typically a factor in the income attributed to intangible capital. Our partnership agreement includes a formula for valuing the intangible capital of the firm, and allocates that value to the individual partners. A fixed return of 10 percent is paid annually to partners for their allocated portion of the intangible capital.

☐ *Personal services of partners and employees.* Historically, the return on tangible and intangible capital together comprise about 20 to 25 percent of our total firm income. The balance is allocated to partners as compensation for their services. This is the only portion of firm income allocated through the evaluation process, since the return on tangible and intangible capital is based on a fixed formula.

A look at the evaluation process in our firm

In our firm, the information resulting from the evaluation process is used during the subsequent year in follow-up sessions between the managing partner and individual partners to identify ways in which their performances can be improved. It is essential that the evaluation process be fair and conducted with integrity if it is to gain the support of the partner group. Otherwise, poor performers will be protected and above-average performers will be discouraged.

An effective, flexible evaluation program must be developed by the firm's leadership. In our firm, the managing partner, with the counsel and concurrence of the board of directors, has the responsibility for designing and developing such a program.

Even though we consider available objective data in arriving at our conclusions, the process is still subjective; therefore, the annual allocation of income between partners is not infallible. It is our goal to compensate a partner fairly over his or her entire career with the firm. So while we attempt to adjust incomes equitably on an annual basis, we encourage partners to think about their contributions and relative share of income over the longer term. If it appears that a partner's performance is significantly out of line with income, the full adjustment might be made over a two- to three-year period to be sure the change in performance is ongoing.

If a partner's performance is considerably below the firm's expectations, both partner and firm must make sincere, innovative efforts to identify and overcome the problems. Then, if all efforts to improve the situation fail, the managing partner and the partner involved should work together to determine whether there is a better alternative for an ongoing and productive career elsewhere.

Listed below are some of the factors our firm considers in evaluating the contribution our partners make to the firm:

☐ Being a team player.

☐ Technical abilities and specialties and the effective use of those abilities with clients, as well as for in-firm consulting.

☐ Marketing results—ability to provide additional needed services to existing clients, as well as to attract new clients.

☐ People skills and supervisory abilities.

☐ Business acumen.

☐ Ability to effectively manage client engagements.

☐ Flexibility (adaptability to change).

☐ Communication skills.

☐ Creativity.

☐ Level of commitment to the firm. (In assessing this, we consider total recorded hours and total chargeable hours, but also consider other evidences of commitment, which may be more important.)

☐ Practice management abilities.

☐ Ability to effectively convert services to cash (billings, collections, and adjustments from standard).

In considering these factors, we tend to look for results—not just activity. However, the results from some activities are not always evident within the year, and so the process is not solely results-oriented.

(Continued on page 5)

AICPA 100
A CENTURY OF PROGRESS
IN ACCOUNTING
1887-1987

The Practicing CPA (ISSN 0885-6931), December 1987, Volume 11, Number 12. Publication and editorial office: 1211 Avenue of the Americas, New York, NY 10036-8775.

Eyeing Tax Season

A few years ago, a patient of long standing—a writer in her early thirties—phoned me in much distress to say that her vision was blurred and that she could not focus her eyes. Having conducted a thorough examination of her eyes each year for many years, I had a record of her general health, the condition of her eyes, the type of work she does, and, importantly, her work habits. I was fairly certain I knew the reason for this particular visual problem.

The subsequent examination revealed what I suspected. The patient had severely strained her eye muscles—creating a "visual charley horse." While this is not unknown to optometrists, it is an extremely rare occurrence.

The cause of the problem was the patient's continuous involvement in near-point tasks—often for periods of eight hours or more. The prescribed cure was that the patient walk away from the desk for five minutes every hour, look out of the window, and focus on distant objects.

Proper vision care necessitates more than this simple exercise, however, if the individual is to work efficiently and accurately for extended periods of time. With a long, arduous tax season ahead, CPAs might like to consider some suggestions for improving visual skills and reducing the possibility of eyestrain and fatigue.

First, having 20/20 vision does not mean that you have perfect vision. It means that you can see at twenty feet what the normal eye can see at that distance. It means nothing at the reading distance. What is right for seeing clearly at a distance may not be right for near-point vision. These are entirely different visual tasks.

Vision should not only be clear at all distances—it should be comfortable and efficient as well. Don't accept discomfort such as headaches and eye fatigue—blurring, double vision, inability to sustain tasks—as the norm. It is not. If your eyes are not properly corrected for the task being performed, however, they will be under stress and tire you, much as any overexercising will.

The age of the individual is an important factor, too. People over the age of forty are more likely than those younger to have near-point vision problems. The crystalline lens of the eye loses some flexibility after forty-five and the ability of the eyes to focus and remain focused deteriorates. Changes in lens flexibility continue until about the age of sixty-five.

Hyperphoria—the tendency of each eye to see objects at different levels—is a fairly common eye disorder, but one that is often undiscovered and rarely treated. The symptoms include head tilt and neck ache, blurred and/or double vision, discomfort in crowded places such as supermarkets and department stores, inability to read in a car or bus, and a tendency to motion sickness. For CPAs and their staff who might have the disorder and not have been treated for it, difficulty in tracking a line of figures across a ledger or tax return, or trouble focusing on a CRT screen will add to the seasonal burden.

The eyes have to focus on a CRT screen that is 18 inches to 24 inches in front of the user, as opposed to the usual 14- to 16-inch distance for most reading and writing. Also, the screen is reflective and often at an upright angle. These visual requirements are, therefore, different from most needs that can be met by normal corrective or reading lenses; about 30 percent of the people in a typical office will not see the screen comfortably and will need help.

Because the Snellen wall chart (the usual testing method) only tests for distance vision, I developed a device a few years ago, the EYETECH Vision Screening System, that enables a trained layperson to test employees for CRT-related vision defects. (For further information, just call or contact me at the address below.) Again, though, proper vision care necessitates more than tests by trained laypersons. A regular and thorough examination by an eye specialist is essential.

How an examination can help

Such an examination will take thirty to forty-five minutes including binocular tests to see if both eyes coordinate easily and comfortably. It should also include checking on the patient's general health through the eyes.

The back of the eye is an important diagnostic area, and tests will reveal early signs of diabetes, high blood pressure, cataracts, and glaucoma. Annual tests are essential for everyone over forty years old.

There should also be an emphasis on the history of the eyes and the visual tasks with which the patient is involved. Here you can help by making sure your eye specialist knows what type of work you do, and how and where you do it. You can measure the distance from your eyes to your desk, calculator, computer, etc., so that a correct prescription can be evaluated for all working distances. Sometimes there is a need for different prescriptions and glasses to suit particular aspects of a patient's vocation.

Finally, the examination should include time for the eye specialist to explain what the prescription is for and answer the patient's questions. As with your clients, the goal should be to anticipate and prescribe for next year's needs. ☑

—by Melvin Schrier, O.D., F.A.A.O.
539 Park Avenue
New York, N.Y. 10021 (212-755-2020)

Audit Planning

The planning phase is an important part of every engagement. It entails reviewing the client's business and the industry in which the client operates, and developing an overall strategy for the expected conduct and scope of the engagement. The need for planning is highlighted in rule 201, General Standards, AICPA *Code of Professional Ethics*, which states: "A member shall adequately plan and supervise an engagement." Proper planning also enhances the productivity of engagement personnel, and should result in a more profitable engagement.

The technical information division of the AICPA recently developed a booklet, "Audit Planning," that contains illustrative audit assignment control forms, engagement letters, and a planning checklist that can be used by accountants in the planning phases of audit engagements. One of the chapters, for example, deals with assessing audit risk and materiality and includes the worksheet below.

Sample Planning Materiality Worksheet

	Initials	Date
Done	______	______
Reviewed	______	______

Client Name
Planning Materiality Worksheet
Balance Sheet Date

1	Unaudited total assets at balance sheet date	____________
2	Unaudited total revenues at balance sheet date	____________
3	Select the larger of line 1 or 2	____________
4	Select a multiplier if audit risk is normal, or, if better than normal, select .01	____________
5	Multiply line 3 by line 4	____________
6	Unaudited pre-tax income (or equivalent if not a for-profit entity)	____________
7	Select a multiplier if audit risk is normal, or, if better than normal, select .1	____________
8	Multiply line 6 by line 7	____________
9	Evaluate lines 5 and 8 along with other relevant factors and determine materiality for audit planning purposes	____________

The contents of the booklet are nonauthoritative practice aids, and practitioners are urged to consider other sources of illustrative material, such as that in authoritative pronouncements and AICPA audit and accounting guides. Nevertheless, "Audit Planning" can help practitioners establish consistency of practice throughout their firms.

Copies of the booklet (product no. 008021) are available to members at $10.00 each ($12.00 for nonmembers). Just call the AICPA order department's toll-free numbers: United States (800) 334-6961; New York State (800) 248-0445. ☑

New Software Package—Accountant's Trial Balance

The AICPA recently announced a software program, "Accountant's Trial Balance" (ATB), that gives an accountant with access to a personal computer an easy-to-use trial balance calculator and workpaper generator. The program is designed to be used for compilations, reviews and audits, and to assist in generating and organizing the figures needed for tax returns and financial statements.

With ATB, you can easily

☐ Set up and use the trial balance and related lead schedules.

☐ Post year-end or interim adjustments.

☐ Adapt the format to conform to workpapers that were previously manually prepared.

☐ Generate analytical review workpapers that can be used by CPAs in the course of an audit or review. These include variance and ratio comparisons with the prior year and/or budget, as well as user-oriented industry averages.

The program can handle the broad range of clients served by CPA firms, and can accommodate account numbers of up to twelve alphanumeric characters. ATB will run on an IBM PC, XT, AT, PS/2, or compatibles with a minimum of 640k of memory and two diskettes, or a diskette and a hard disk drive. The program will be shipped in 5¼-inch and 3½-inch formats. Telephone support is available from the AICPA software support department: (212) 575-5412.

ATB (product no. 016300) lists for $295 ($236 for AICPA members), with a full money-back guarantee, and is scheduled for shipment in December. For buyers who order before January 1, 1988, the prepublication price is $240 for nonmembers and $195 for members.

To order, call the AICPA's toll-free numbers: United States (800) 334-6961; New York State (800) 248-0445. ☑

Partner Evaluation *(Continued from page 2)*

There are a number of questions firms should consider as they develop partner evaluation programs. For example

Should the process allocate income prospectively or retrospectively? Some firms allocate at least a part of their income at the end of the year by looking back. In our firm, we evaluate performance retrospectively and allocate units based on conclusions about relative performance. The result of that process is then used to allocate income for the next year. This is consistent with our emphasis on fair allocation of income during the entire career span.

Who should have the authority to evaluate and allocate income? In our firm, the board of directors has this authority. In other firms, it may be the entire partner group or a separate evaluation committee.

Should the conclusions be based on subjective or objective criteria? While we do develop a significant amount of statistical information that the board of directors uses during the process, we believe that an *excessive* emphasis on chargeable hours, for example, can be counterproductive since it discourages other productive activities. We obtain confidential, written, subjective evaluations from other partners (as well as self-evaluation information), and this information, together with available objective data, is used in coming to a subjective conclusion about the relative contributions of the individual partners.

Should the managing partner have a strong role in the process? Our managing partner is a member of the board of directors. Another member of the board is appointed annually to be the chairperson of the evaluation process, however. The managing partner has ongoing involvements with individual partners and has significant knowledge about their contributions to firm income. The board solicits the managing partner's views on partner performance, but these opinions are not overriding. As the firm has grown, input from office PIC's about the performance of partners in their offices has become an important factor.

Is it ever appropriate for all partners to have equal incomes or for certain groups of partners to have equal incomes? It may be appropriate when two people first go into practice together. Over time, however, it is unlikely that two people will demonstrate equal abilities or desires to contribute to the success of the firm. In our firm, each partner is evaluated on the basis of individual performance.

What is a realistic spread between the highest and lowest incomes? It depends on a number of factors, including individual abilities and commitment, and the firm's philosophy with respect to partner admission. In many mid-size firms (10 to 50 partners), the income of the highest-paid partner is four or five times that of the lowest-paid partner. We find that people are more concerned with their *relative* income positions rather than with absolute numbers.

Applying the process

Each year, we prepare a statistical summary of each partner's performance over the last five years. The summaries, which are available for consideration by the board of directors during the process, include the partners' forecasts of their hours for the coming year and the following historical data for each partner for the previous five years:

☐ Annual net billings supervised.
☐ Percent of adjustment from standard rates.
☐ Write-offs of uncollectible accounts.
☐ New business volume (estimated annual fees from new clients).
☐ Terminations (estimated annual fees of terminated clients).
☐ Chargeable hours.
☐ Total hours.
☐ Annual income.

In addition, each year, the partners are invited to submit information about their activities that is not generally apparent. Then, every second year, the board gathers input from partners about the performances of their peers. The board uses this information in its discussions of partners' performances—a process which typically takes about two days each year.

Again, it is important to emphasize that there is no one formula or method that is best for all firms. Each firm, however, should develop a program that will be perceived as fair, so that it will be accepted and supported by the partner group. Carefully planned and orchestrated, the partner evaluation process has the potential to be an excellent vehicle for developing partner communication and motivation, and for developing more cohesiveness within the partner group. ☑

—by Rholan E. Larson, CPA
Minneapolis, Minnesota

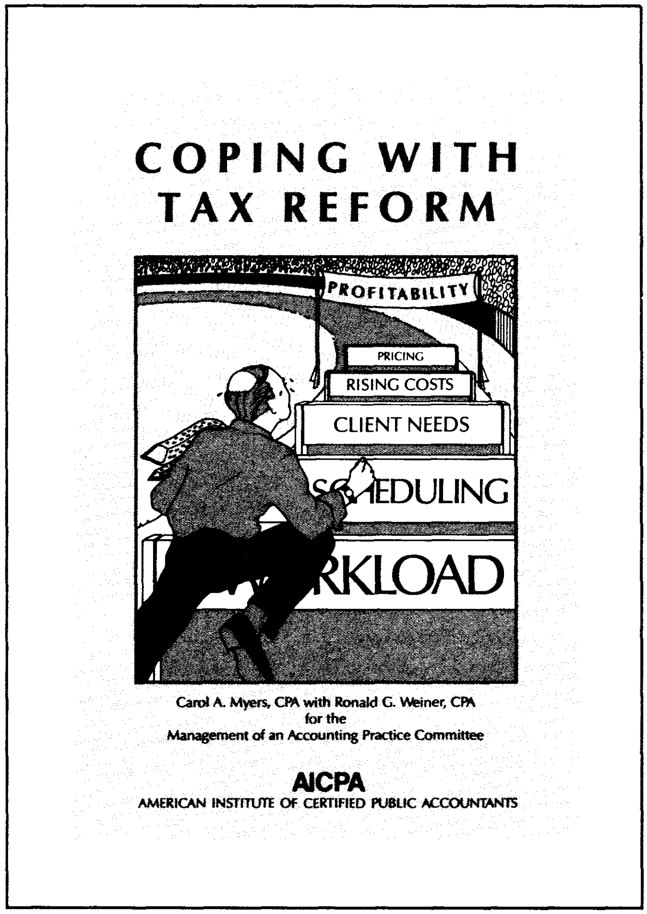
Coping with Tax Reform

Because it creates a dramatic shift in workload and a substantial increase in year-end work, the Tax Reform Act of 1986 will have a significant impact on the profitability of every small- and medium-size practice. The AICPA has developed a practical guide, "Coping with Tax Reform" (see page 8 of the September issue), to help practitioners understand the issues affecting their firms and deal with many of the operating burdens that result.

For example, "Coping with Tax Reform" contains advice on

- ☐ How to prepare to meet peak capacity and demand.
- ☐ How to evaluate your billing practices to achieve an optimum balance between the number of clients and revenue.
- ☐ How to determine whether additional client billings will more than offset the additional costs incurred.
- ☐ What to do about long-standing clients who may be hurting your profitability because of "below standard" rates.

The guide (product no. 889295) is available to members at $12.00 each ($15.00 to nonmembers). To order, call the AICPA's toll-free numbers: United States (800) 334-6961; New York State (800) 248-0445. ☑



1986–1987 Index

American Institute of Certified Public Accountants, Inc.
1211 Avenue of the Americas
New York, N.Y. 10036

Non-Profit Organization
U.S. POSTAGE
PAID
American Institute of
Certified Public Accountants